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MEMORANDUM FOR	OVP	- Mr. Phillip Hughes
	State	- Mr. L. Paul Bremer, III
	OPD	- Mr. Les Denend
	NSC	- Mr. Michael O. Wheeler
	Agriculture	- Mr. Raymond Lett
	CIA	- [redacted] STAT
	Commerce	- Mrs. Helen Robbins
	Defense	- Col. John Stanford
	USTR	- Mr. Dennis Whitfield
	CEA	- Mr. William Niskanen
	OMB	- Mr. Alton Keel

Subject: Interagency Group on International Economic Policy (IG-IEP) -- U.S.-Indian Economic Relations

Attached is a paper on U.S.-India Economic Relations which is based on papers prepared for and discussions in the Interagency Group and subsequent comments we received from agencies. This paper has been circulated for discussion by the SIG-IEP on Tuesday, September 28. If you have any additions or comments, please call Michael O'Connor at 566-2012 with your specific wording changes by noon, Monday, September 27, so that we may circulate them to SIG participants.

David E. Pickford
Executive Secretary

Attachments

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AGENDA ITEM 4

U.S.-INDIAN ECONOMIC RELATIONS

In order to safeguard important political and security interests at stake in U.S. relations with India, the President has directed the SIG-IEP to explore and present for NSC consideration ways in which the United States might support India in its development efforts.

At an Interagency Group (IG) meeting on September 1 there was a consensus that (1) in the near-term and in view of India's own priorities, we should focus on multilateral assistance and how the United States should fulfill its commitment to higher levels of MDB hard window borrowing; and (2) for the longer-term, we should take steps now to foster an economic relationship based more on expanding commercial ties and less on aid. The purpose of the SIG meeting is to consider steps we might take to fashion a more positive economic relationship with India within the constraints of US policies and regulations. If there is agreement, these measures could be transmitted to the NSC by September 30.

1. Indian Borrowing from the World Bank. The United States should support growth in total Indian borrowing from the MDBs in order to enable India to deal better with its development problems and to continue the liberalization of its economy. In addition, given IDA/IBRD funding constraints, the more active participation of a major new borrower (i.e. China), and an increased Bank focus on the African region, growth in India's FY 83-86 borrowings vis-a-vis FY 79-82 borrowing will likely increase only in nominal terms. The U.S. position on Indian borrowing from the World Bank, however, must clearly reflect U.S. policies of reducing India's share of IDA credits and moving India toward harder IBRD loans. The United States will, therefore, work toward greater Indian access to IBRD lending, within the limits of future replenishments and Congressional appropriations, in order to offset reductions of IDA credits to India.

2. Indian Request to Borrow from the Asian Development Bank (ADB). Before the Gandhi visit, Treasury and State agreed that the United States would see if it was possible to prevent India's borrowing from the ADB through high level contacts with Japan and possibly others. If preventing Indian borrowing seemed unrealistic, it was agreed to seek to limit any such borrowing to a modest amount. Since then the Japanese have indicated opposition to Indian borrowing. If they hold firmly to this position, the chances seem good of preventing lending to India, without signicantly damaging bilateral relations via an overt U.S. campaign. The key to our strategy should be to work closely with the Japanese and ADB management on this issue. If there were to be ADB lending to India, it could generate Congressional opposition to the ADB and possibly place all pending MDB legislation at risk; e.g., Indian access to the ADB could have negative spillover effects on ADF, ADB, and World Bank legislation.

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3. Indian Borrowing from the IMF. On the assumption of a continuation in India's good performance to date under the IMF program, India's continued need for large balance of payments assistance, and the appropriateness of the third-year targets, the United States hopes to support the third year of the program. During the first year of India's 3-year (1981-83), $5.8 billion Extended Fund Facility, the Indians implemented the program well. Although the United States abstained on the first year of the program because of doubts about the need for a loan of this size and India's commitment to adjustment, it supported the second year because the Indians had met all performance criteria and were making significant progress on achieving structural adjustments, long advocated by the World Bank as well as in the IMF program.

4. Expanding Commercial Ties. We are in the process of promoting greater trade and technical collaboration with India, e.g, through the planned OPIC and trade missions next year. We regularly discuss the range of trade issues with the Indians. The Indians do not seem to be interested in some commercial - related initiatives, such as the North/South trade discussions in the GATT ministerial or a bilateral investment treaty. The Indians do want greater access to the U.S. market for their exports, but there are severe limitations on the ability of the United States to be more open to Indian products. Nevertheless, we could propose a meeting with the Indians at the sub-cabinet level in order to explore trade and investment objectives to determine the extent of mutual interest and to demonstrate U.S. goodwill in seeking closer, mutually beneficial ties.

5. Congressional Views on India. India's current government is giving greater scope to the Indian private sector, foreign investors, and market mechanisms in the country's economic development. Recent changes in India's economic and foreign policy may not yet have been recognized in Congress. Its strategic interest to the United States may not be fully appreciated. It has also generally taken fairly pragmatic positions in international fora. If we are to effect any improvement in U.S.-Indian economic relations, the Administration should launch a quiet educational campaign on the Hill to inform legislators about the recent evolution in India's economic performance and policies.

Attachments

The attached paper from State provides background and a rationale for the President's directive on India and proposes an overall economic strategy. There is also a paper which might be used for contacts with the Congress. Also attached are background papers on the Indian business climate, climate for economic development, and U.S.-India trade relations prepared by the participants in the IG meeting of September 1 on India.

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An Economic Strategy for Managing Our Relations with India

India's size, industrial muscle, military capabilities and political stability make it an intrinsically important regional power. These factors give India central importance in any consideration of U.S. security interests in the South Asia region and adjacent areas such as Southwest Asia and the Persian Gulf. India is capable of taking actions which affect those interests, particularly in Pakistan and Afghanistan. As the President has directed, it is essential that we be able to relate positively to India in its development efforts in order to safeguard important U.S. political and security interests at stake in our relations with India.

U.S. Objectives

Our approach to this task has had two objectives. In the short term we want to avoid provoking Indian actions that could be harmful to our security interests in the region of South and Southwest Asia. Our strategy there is in significant part premised on a militarily strong Pakistan capable of resisting Soviet pressure from Afghanistan. If the Indians become convinced that there is little advantage to them in a constructive relationship with the U.S., and considerable danger as a result of our r lationship with Pakistan, their reaction could grow from critical rhetoric to more concrete actions, possibly in concert with the Soviet Union.

Our objective over the longer term should be to build a relationship of mutual benefit with India which reflects its intrinsic importance in South Asia and beyond. In doing so, we can serve a variety of important U.S. foreign policy interests. First is a loosening of the close relations India has had with the Soviet Union for the last two decades, including a more helpful stance toward efforts to bring about Soviet withdrawal from Afghanistan. Second is the promotion of regional detente, particularly between India and Pakistan and India and China, leading to greater stability in the area, a longtime U.S. goal. To the extent this can be achieved, it will lessen India's felt need for a Soviet counterbalance to the threats it presently perceives from Pakistan and China, and the sensitivity to Soviet interests which this encourages.

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Indo-Pakistani and Sino-Indian reconciliation also will improve the prospects for nuclear detente in South Asia. Further, better Indo-U.S. bilateral relations can facilitate our wider non-proliferation objectives in that they will provide a basis for a constructive dialogue with India on nuclear issues. Finally, while India and the U.S. are apt to continue to find themselves at odds on certain specific issues for the indefinite future, improved bilateral relations may, over time, have a positive spillover effect in the form of greater Indian sensitivity toward U.S. interests in various international fora.

Developing A Strategy

Foremost among our assets is India's own desire for better balance in its relationships with the two superpowers. This provides us with an opportunity. But to capitalize fully on it we will have to be able to demonstrate to India that there are tangible benefits to be derived from improved relations with us. It is clear from Mrs. Gandhi's comments during her visit that she closely associates improved relations with the U. S. with greater U.S. sympathy for India's economic needs as India sees them. Both the will and the ability of the Indian Government to take U.S. interests into greater consideration in its policies will be significantly influenced by our responsiveness in the economic area. In the short term that means, above all else, multilateral assistance.

Mrs. Gandhi recognizes that the Indian economy is today far stronger than it was 20 years ago and that it promises to be stronger yet in the future. Nonetheless, she and her chief advisors see a transitional period ahead during which India will continue to require assistance on concessional and partly subsidized terms. We can differ with India on the specifics (such as the length of the transitional period, the mix of funding, etc.). But we cannot be perceived by the Indians as indifferent or even hostile to their economic interests if we are to take full advantage of the opening provided by the successful Gandhi visit which itself demonstrated the enhanced possibility of India taking U.S. concerns into greater account.

Elements of the Strategy

Just as we have short and long term objectives with regard to India, we need a strategy with short term and long term elements for achieving our objectives. Economic and commercial cooperation offers the most promising and effective means to accomplish our objectives throughout this decade. In pursuing our strategy, however, we need to recognize the

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inherent limitations and constraints on both sides. Moreover, we want our approach toward India to reflect clearly the fundamental tenets of U.S. policy regarding Third World development. This means, for example, moving the Indians gradually away from concessional credits toward hard loans and private financial markets, and encouraging them to allow a greater role for the private sector in their development.

In the short term, both from the point of view of Indian priorities and what we ourselves can reasonably do to protect our interests we should focus on multilateral assistance. The State-Treasury agreement reached just prior to the Gandhi visit provides a framework for this. Growth in total Indian borrowing from the MDBs will enable India to deal better with its development problems and to continue its more liberalized economic approach. Indian success in this regard will enhance stability in India itself and the region at large. At the same time, the risk of India taking actions inimical to our interests because of our policy toward IDA will be lowered.

Taking a reduction of India's share of IDA-7 as a given, there are three means of fulfilling the State-Treasury agreement:

1. More IBRD lending (India's share would have to be increased sharply unless we reconsider our preference for not accelerating the GCI);

2. An annual U.S. contribution greater than $750 million to IDA-7 (thus offsetting somewhat the net effect of a reduced percentage share of IDA for India); and as a possible supplement

3. Some borrowing by India from the ADB (Japanese opposition to Indian borrowing would eliminate this option).

None of these alternatives can be implemented without difficult policy decisions and some combination of them may prove desirable. State and Treasury will have to work closely together in weighing the political and economic advantages and liabilities of various scenarios.

In the second half of the 1980s, as the considerable investment in India's petroleum sector already underway begins to pay off in reduced (in real terms) oil import bills, we can move increasingly to a relationship with India based less on aid and more on trade and other private sector commercial activities. The Indian economy is becoming more integrated into the international economic system as evidenced by its

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growing requirements for western technology, finance, and markets and by its improving business environment. We want to encourage these directions so as to link India's basic economic interests more closely to the West, thus better protecting U.S. security objectives in the region and promoting a more positive Indian posture, and influence on other developing countries, in multilateral fora. The key elements of the U.S. approach should be to:

-- Promote commercial ties in order to increase Indian reliance on the U.S., strengthen the role of the (generally pro-Western) Indian private sector, and build business constituencies with a stake in each other's countries. Despite the shortage of competitive export credit financing, there is good scope for U.S. business in India's rapidly expanding energy and electronics sectors. We want to stimulate greater willingness by U.S. firms to consider collaborations in India through such means as OPIC and trade missions, joint projects in third countries, a bilateral tax treaty and encouragement of a better business climate in India.

-- Consider ways to allow India to increase its exports to the U.S. in order to strengthen India's stake in the bilateral relationship and provide an enhanced alternative to trading with the USSR which offers flexible and advantageous terms. Especially, in view of a growing debt burden, stagnating aid, and a large balance of trade deficit with the U.S., the Indians want to expand their exports to the U.S. market. They seek more advantages under GSP and easier access for their products, both those currently being exported to the U.S. and the more sophisticated ones they hope to introduce. Given the constraints of policy and regulation on us, it will not be easy to devise meaningful concessions, as is evident in the current negotiations of the bilateral textile agreement and the prolonged dispute over countervailing duties. It will be critical, however, to do so if the U.S. is to relate positively to India in its development efforts in the longer term.

-- Respond to Indian desires for closer bilateral consultations on international economic issues in order to foster Indian cooperation, moderation, and, when helpful to us, leadership in Third World fora. India already understands that its interests are served by practical cooperation with the IFIs and by working with the Western market system rather than by philosophical posturing in international fora. We should seek to engage the Indian economy and policymakers in ways which reinforce this approach. Joint efforts in tackling such problems as foodgrain insufficiency in other LDCs would help symbolize Indo-U.S. mutuality of interest.

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-- Obtain assurances from India that controlled U.S. exports of high technology will not be diverted to the USSR nor to nuclear proliferation. DOD, in particular, has been concerned about the extent of Soviet access to U.S. high technology provided to India, and regularly resists the granting of export licenses. We need to design a licensing approach to India that both satisfies our security concerns and convinces India of our reliability as a supplier of advanced computers and other sophisticated technology. These and other arrangements would tie India's modern economy closer to us over the long term and tend to add distance in its relations with the USSR.

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Negative Legislative Views on U.S.-Indian Economic Relations

The Congressional attitude towards India is a major constraint on expanding MDB lending to India or granting it any non-reciprocal trade concessions. Misconceptions about India on the Hill may partly account for this attitude. An Administration effort to correct the state of misinformation on India might help defuse Congressional opposition to Administration attempts to "relate positively to India in its development efforts," as the President has directed. Recent Indian economic successes and improvements in policy, as well as background on Congressional views, are summarized below.

India -- Improved Climate for Economic Development

Prime Minister Gandhi's present government is giving greater scope to the Indian private sector, foreign investors, and market mechanisms in the nation's economic development strategy. Further liberalization of the business environment together with continuation of the responsible macroeconomic and pricing policies implemented during the first year of India's 3-year IMF program would make India a more open and dynamic economy and one with which the United States could expect greatly increased commercial ties. Some recent developments encouraging for expanded U.S.-Indian economic relations are summarized below:

1. Three-Year International Monetary Fund Program

In November 1981, the IMF approved a three-year Extended Fund Facility (EFF) for India. This loan, in the amount of SDR 5 billion ($5.8 bilion), represents the largest loan that any IMF member country ever received.

During the first year, the Indians implemented the program well and important steps toward structural adjustment, long advocated by the World Bank as well as the IMF, were taken. Price controls on iron and steel were lifted. Significant progress was made toward reducing government control of the cement market. Imports were liberalized. As percentage of GDP, the government managed to reduce expenditures and raise revenues. Monetary growth declined. Real interest rates available to savers turned positive, reflecting both the decline in inflation and higher nominal rates.

In July 1982, the IMF approved the second year of the EFF Arrangement. Although the United States abstained on the first year of the program because of doubts about the need for a loan of this size and India's commitment to adjustment, it supported the second year because the Indians had met all performance criteria and were making significant progress towards achieving the necessary structural adjustments. On the basis of the good performance to date and a continued need for large balance of payments assistance, the United States would expect to support the third year of the program.

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2. Policy Toward Foreign Investment. While the government retains a highly selective stance toward foreign investment, it has begun to promote foreign "collaborations" (Indian parlance for direct investments or licensing agreements) to manufacture export-oriented products or to provide technology not available locally. The climate has evolved considerably from the 1970s when "Indianization" was on a marked rise -- and Coca-Cola and IBM closed their Indian operations as a result. Approvals of foreign collaborations have risen dramatically in recent years, and the United States has led all other countries in the number of ventures. Despite a number of improvements, however, multinational corporations generally continue to be wary of India's insistence on minority equity ownership for foreign investors and a significant export commitment. U.S. companies view India's efforts with cautious optimism and feel that, although India has taken some measures to make foreign investment more attractive, more could be done.

3. Trade Policy. On April 5, 1982, the Indian Government announced a new import/export policy which: 1) liberalized the import of raw materials, components and machinery to strengthen India's domestic production base and to further stimulate exports; 2) linked imports to export promotion for the first time; 3) simplified or removed import procedures, encouraging manufacturers/exporters to expand output and make their products more competitive in international markets. It contained virtually no additional restrictions and removed numerous procedural constraints across the board. It signalled a marked acceleration of the trend initiated with the 1978-79 import policy, which was tentative and heavily qualified. India has also aided U.S. objectives in North/South discussions on trade in UNCTAD and in the GATT by taking positions considerably less strident than many of its G-77 cohorts.

The tenor of U.S.-India trade relations will be affected in considerable measure by India's ultimate policy stance with respect to the U.S. initiatives for the GATT Ministerial. The United States has taken, and continues to take, gradual steps to improve our trade relationship with India, particularly in view of India's import liberalization moves. It should be noted, however, that even our limited steps in this direction are made more difficult by India's own policy positions (e.g., continued import restrictions on certain U.S. products and disagreements about the administration of our countervailing duty law) and by the Congressional and domestic criticism these generate.

Background

There is considerable opposition in the Congress, particularly among conservatives, to the past World Bank practice of allocating 40 percent of IDA resources to India. Increased IBRD and/or ADB lending to India could also generate similar criticism, even among non-conservative supporters of the institutions.

Critics of past MDB lending levels to India have cited both a political and an economic rationale for their position. On the

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political side, India's often well publicized views on such issues as Vietnam, Pakistan, and North/South have fostered a widespread perception that India's "neutral" foreign policy is both "pro-Soviet" as well as detrimental to U.S. interests.

In the economic area, India is often perceived as one of the classic cases where a combination of inward looking statist and socialist policies have wasted or significantly diluted the impact of large-scale foreign assistance inflows. Policies which have discouraged foreign investment and other private flows -- reinforced by India's tendency to view North/South cooperation primarily in terms of "aid" -- have also left India without the private sector interests on which other major LDCs (e.g. Mexico and Brazil) can rely to influence Congressional opinion. The fact that India is a nuclear power which has not signed the Nuclear Non-Proliferation Treaty and the widely shared impression that India maintains high defense expenditures (fostered perhaps by its well publicized purchases of foreign military equipment) have further diminished Congressional sympathy for India's development problems. (In fact, however, as percent of GDP, India's defense expenditures are less than the LDC mean, i.e. 3.08 compared to 3.95 for the LDC average).

On the other hand, there has also been broad Congressional support for the Administration's position that concessional IDA resources should be better concentrated on those low-income LDCs which, unlike India, do not have either the access to, or the ability to sustain, both official and commercial borrowings on harder terms.

In addition, budget conscious Congressmen have been wary of India's large absorptive capacity, a concern accentuated by the recent emergence of China as another potentially large claimant on MDB resources. With regard to Indian access to ADB resources, there is a strong Congressional feeling that Indian borrowing would be highly detrimental to the ADB's other, generally small and medium size, borrowers and fundamentally alter the nature and character of the institution. (The fact that the ASEAN countries and Korea currently receive 90 percent of the ADB's capital resources has been a major selling point for ADB legislation on the Hill.)

In sum, given current Congressional views, expanding Indian access to MDB resources could generate Congressional opposition sufficiently strong to place all pending MDB legislation at risk, e.g. Indian access to the ADB could have a negative spillover effect on IDA and GCI legislation.

Many members of Congress, and in particular those on the House and Senate trade subcommittees, view India as a difficult trading partner that pushes for increased access to the U.S. market without demonstrating any willingness to open up its own market in return. Many in Congress strongly opposed as too weak the commitment on subsidies which Ambassador Brock signed with the Government of India in 1981. Further, some believe India should be treated as a more advanced developing country and should graduate to some degree from the preferential trade status it now enjoys. Thus, Congress is unlikely to look favorably upon Administration proposals for increased non-reciprocal trade concessions for India.

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CHANGING INDIAN BUSINESS CLIMATE

Prime Minister Gandhi's present government has come to recognize that the Indian private sector and foreign firms can make important contributions to India's economic development. If current policies are maintained and expanded, India could become a more open and dynamic economy. The United States has tried to encourage this liberalization in bilateral meetings with Indian government officials. We have also tried to foster greater awareness in both countries' private sectors of the new opportunities for increased trade and investment ties.

Industrial Policy. Since independence, India's industrial policy has emphasized import substitution, heavy industry and state capitalism. The record of India's nationalized industries, which hold 3/4s of the country's industrial assets and contribute only 1/3 of its industrial output, has resulted in a situation where industrial jobs have not kept pace with growth of the labor force. Former Prime Minister Desai began and Prime Minister Gandhi has continued to try to reduce obstacles to business growth. Prime Minister Gandhi's relations with large private industrial firms have been good. Her present inclinations suggest that the private sector may enjoy a freer hand over the next few years.

Last year, India introduced a series of measures to promote industrial production including provision of institutional finance for modernization to all industries and simplification of industrial licensing procedures. Units producing solely for export are now exempt from controls on expansion, import duties, local excise taxes and limits on foreign ownership. Previously, only companies setting up in two specially designated export zones (one in Bombay, the other in Kandla) had been given this status. Now the whole country is, in effect, an export zone.

Trade Policy. On April 5, 1982, the Indian Government announced a new import/export policy which:

- Liberalizes the import of raw materials, components and machinery to strengthen India's domestic production base and to further stimulate exports.

- Links imports to export promotion for the first time.

- Simplifies or removes import procedures, encouraging manufacturers/exporters to expand output and make their products more competitive in international markets.

It contains virtually no additional restrictions and removes numerous procedural constraints across the board, representing a signficant disengagement of the import regulatory mechanism. It signals a marked acceleration of the trend initiated with the

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1978-79 import policy, which was tentative and heavily qualified. The policy entails a considerable risk, since it removes many of the qualifications implicit in the 1978-79 policy, reduces significant procedural impediments to imports, and does so at a time when India's foreign exchange reserves are declining. India faces a near record level trade gap. Indian export growth has been slow due to domestic supply constraints, the strong pull of the large domestic market and an increasingly unfavorable international trading environment.

Foreign Investment Policy. While the government retains a highly selective stance toward foreign investment, it has begun to promote foreign "collaborations" (Indian parlance for direct investments or licensing agreements) to manufacture export-oriented products or to provide technology not available locally. The climate has evolved considerably from the 1970s when "Indianization" or greater Indian ownership of industry, was on a marked rise--and Coca-Cola and IBM closed their Indian operations as a result. Approvals of foreign collaborations have risen dramatically in recent years, and the United States has led all other countries in the number of ventures.

U.S. Policy and Initiatives. The United States has tried to encourage Indian government officials to continue in liberalizing directions. While the Indian Government's continuing actions indicate commitment to these policies, there are a number of risks involved. Should the Indian economic situation and balance of payments deteriorate seriously, the Indian Government could come under increasing pressure to replace controls and protect the home market.

In an effort to translate this liberalized business climate into the reality of increased commercial relationships, the Commerce Department is attempting to encourage Indian companies to look to the United States for technology as well as equipment. Commerce is also attempting to make U.S. business aware of the changing Indian business climate and the new opportunities it offers.

Secretary Baldrige invited the Indian Minister of State for Science and Technology to visit the United States last May in order that he might become acquainted first-hand with the latest U.S. innovations in his fields of interest. Commerce also was heavily involved in the planning and support of an eleven-city U.S. visit by leading Indian industrialists from the Indo-American Chamber of Commerce last spring. The aim of this mission was to update U.S. business perceptions of India and to stimulate interest in collaborative arrangements with Indian private firms.

Commerce:
R.D.Harding

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INDIA - IMPROVED CLIMATE FOR ECONOMIC DEVELOPMENT

I. Background - Development Progress

The Indian economy in 1981/82 demonstrated conditions of continuing growth and stability. Real growth was 5% and in line with the GOI's (Government of India's) target for the current Sixth Five Year Plan. Foodgrain production exceeded by 3% the previous year's level and reached a new record of 134 million metric tons. India appears to have its foodgrain supplies under a sound management system which will assure it food security under all but the most severe drought conditions. Increases were recorded also in industrial production and in exports, the former by 8% and the latter by 11%. Oil imports decreased by 8% as a result of increased domestic oil production, providing relief to the balance of payments deficit. The IMF recently approved a second tranche of its $5.6 billion loan to help meet the balance of payments deficit. Shortages in the supply of industrial products were also significantly reduced as administrative and distribution bottlenecks were ameliorated. On the investment side, both public and private corporation levels increased significantly over prior years. Inflation, which had been on an accelerated course, was decelerated. In short, the Indian economy is healthy and following the right path to further growth and assured stability. The climate it provides for broad-based development efforts is agreeable and conducive to these efforts.

II. Agricultural Development

A. The Spread of Agricultural Technology

The adoption of producer oriented pricing policies, a strong emphasis on research and extension and the introduction of High Yielding Variety (HYV) strains on wheat and rice had a dramatic impact on Indian agriculture. As of 1981, HYV wheat accounted for 80 percent of all wheat acreage and HYV rice accounted for 52 percent of all rice acreage. Wheat and rice have averaged annual yield increases of 1.8 and 1.6 percent respectively since 1970. Cereals production has nearly doubled since 1965.

B. Irrigation

Irrigated areas have increased from 18 percent to 29 percent of net sown area over the past 30 years. However, production is still heavily dependent on the highly variable summer monsoon rains. Continued expansion of the irrigation systems is essential to increasing foodgrain yields and net incomes to farmers. India plans to double its irrigated acreage from 55 million hectares to 107 million hectares by the year 2000. Over the past 3 years, the GOI has shown an increasing awareness that effective irrigation systems require more than proper engineering structures. The GOI has demonstrated a determination to address the managment and institutional constraints on the efficiency of current and planned irrigation systems. Given the availability and quality of U.S. expertise in this area, the GOI is highly receptive to U.S. technical collaboration in developing new institutions for irrigation management, training and technology development.

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III. Economic Reforms

India has introduced a large number of policy reforms in response to donor entreaties (especially from the IMF and the IBRD) but also as part of its recognition of the need to introduce major reforms if the Indian economy is to grow at a rate greater then its population. This section will briefly discuss some of the changes made in four sectors of the economy.

A. Prices/Subsidies

An integral objective of the Donor Community and India has been to increase prices administered by the government so as to rationalize the pricing system and reduce the burden on the government's budget. For example, petroleum prices were revised substantially in June 1980, January 1981 and July 1981. Petroleum prices are currently considerably above oil import costs and constitute progress toward the more efficient utilization of gasoline and its conservation. The July 1981 adjustments tripled the price of domestically-produced oil, the first increase since 1975. Also, steel and aluminium prices were raised by about 18 percent and 20 percent respectively; pig iron was raised by 38 percent; fertilizer prices were raised in FY 1980/81, resulting in a savings in the fertilizer subsidy bill of RS 10 billion.

B. Trade

Since 1980 a number of reforms have been introduced to stimulate exports and remove restraints on imports. Specifically, a scheme for 100 percent export - oriented units now permit these units to be set up anywhere in the country with the same duty-free access to imports that normally are provided only in free trade zones. An Fxport - Import Bank was established in 1980 to finance long-term export credit. A new scheme was introduced to meet the import requirements of the small-scale industries through export houses and the Small Industries Corporation of the State Governments. In addition, forty-seven items were added to the list of items eligible for duty drawback on exports and restrictions on imports have been relaxed to permit increased access to raw materials and intermediate goods. A large number of goods can now be imported under an open general license. Moreover, the GOI has made an explicit commitment to the IMF that it will pursue realistic exchange rate policies.

C. Agriculture

Agriculture contributes 40 percent of India's GNP. The growth of agricultural production, particularly foodgrains, generally has been satisfactory in the past few years. This growth results from a number of factors, including irrigation and HYV, but also from several policy reforms that moved the agricultural sector in the right direction.

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--Support prices for foodgrain have been increased by 10 percent for paddy and 11 percent for wheat.

--Official grain stocking efforts have generally been successful and prevented serious disruption to food supplies due to the 79/80 drought. In order to ensure that stock levels are maintained, the GOI imported grains in 1981 and 1982.

D. Private Sector

Policies relating to private sector industry are aimed at encouraging production, investment and economic efficiency. In July 1980, the GOI issued an "Industrial Policy Statement" that permits automatic capacity expansion approval for 19 industries (in addition to the 15 industries that previously had received this approval). At the same time, incentives were established for any unit that is 100 percent export oriented; this includes duty free imports of capital goods and raw materials and concessions in central government excise taxes. In 1981, 14 groups of industries were added to the list of those eligible for specific investment related tax concessions and surcharges on income tax payable by all classes of companies were reduced from 7.5 percent to 2.5 percent. Also, in 1981, the GOI permitted the private sector to establish new power plants to supplement public sector electricity generation.

IV. Role of Foreign Assistance

A. Official Flows

The concessional assistance provided primarily by the members of the World Bank-led India Aid Consortium, and the balance of payments relief from the IMF's Extended Fund Facility (EFF) play very significant roles in agricultural development and in macroeconomic policy reforms.

The major donors in the agriculture sector, the World Bank and the U.S., emphasize increasing the efficiency of irrigated water use through complementary capital and PL 480 Food for Work projects, although their approaches differ. Nevertheless, the technological changes that are being introduced through both donors projects agree and are producing policy changes to improve how irrigation systems are constructed, operated and maintained.

All of the donors with major programs in any agriculture sub-sector, e.g., irrigation, extension, research, are influencing policy changes in that sub-sector, regardless of whether the change has a production, technological, or administrative focus, or a combination of these. To a lesser extent, donors have been able to influence key areas of overall sector policy, such as procurement pricing, subsidies, and food stock levels.

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B. Private Foreign Investment

For years, India has been a challenge for foreign business, with profitability rarely greater than eight or nine percent, restrictions on repatriation of profits and dividends, and forced dilution of equity held by foreign-owned firms. The result has been an outflow of investment funds by investors weary of legal disputes and complicated bureaucratic procedures. Recently, however, the Indian position regarding foreign investment has been changing, and a new policy is emerging, primarily due to the country's need for new technology and a severe balance of payments deficit. Despite a number of improvements, however, multinational corporations in general continue to be wary of India's insistence on minority equity ownership for foreign investors and a significant export commitment. U.S. companies view India's efforts with cautious optimism and feel that, although India has taken some measures to make foreign investment more attractive, more could be done.

The United States is the second leading source of foreign investment in India behind the United Kingdom. At year end 1980, the U.S. direct investment position in India stood at $396 million, up 16 percent from $341 million at year end 1979 and up eight percent from its former peak of $367 million in 1975. The United States followed closely by the U.K. and Germany, has emerged as the major supplier of technology. The other sources of technology inflow were Japan and Switzerland, followed by France and Italy. On average around 15 percent of collaboration agreements had some financial implications though the amount of foreign equity investment was extremely small--a total of US $70.6 million in the years 1971-80. US companies again tended to have a relatively higher proportion (22 percent) of financial participation.

In sum, private foreign investment in India has been and continues to be quite small. Since 1980 a sense of cautious optimism has emerged in the U.S. business community regarding new investment opportunities in India. This mood is in direct contrast to the prevailing feeling of frustration evident in earlier years.

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U.S. - INDIA TRADE RELATIONS

DESCRIPTION

Trade has been a dynamic and generally constructive element in our bilateral relations with India. Bilateral trade has nearly doubled in recent years, increasing from $1.5 billion in 1977 to $2.9 billion in 1981. U.S. agricultural exports to India also are significant and have grown substantially -- from $256 million in 1970 to $476 million in 1981. In addition, India is a major participant in the U.S. GSP and has doubled its duty-free shipments under the program from $76 million to $161 million since 1976.

The United States in the past has taken various steps in the trade area to aid India. Specifically,

-- We have added 11 products to our GSP eligible list at the request of India.

-- We accepted another 3 Indian requests for consideration during this year's GSP product review.

-- We have consistently redesignated India on all eligible GSP trade.

-- We have not graduated India on any GSP product.

-- Specifically at the request of India, we have established certification procedures to allow inclusion of folklore textile products in the GSP.

We can continue to aid India through these and other such measures, but there are considerable difficulties associated with moving too quickly or too far in this direction. Many members of Congress, and in particular those on the House and Senate trade subcommittees, view India as a difficult trading partner which pushes for increased open access to the U.S. market without demonstrating any willingness to open up its own market in return. Many in Congress strongly opposed as too weak the commitment on subsidies which Ambassador Brock signed with the Government of India in 1981. Further, some believe India should be treated as a more advanced developing country and should graduate to some degree from the preferential trade status it now enjoys. Thus, Congress is unlikely to look favorably upon Administration proposals for increased non-reciprocal trade concessions for India.

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Further, India's own policies sometimes have complicated our bilateral and multilateral trade relationship. India applies import restrictions against certain U.S. products which have had an adverse effect on our export opportunities there. They also disagree with certain aspects of U.S. administration of its countervailing duty law and have threatened to challenge us in the GATT on those points. Most recently, India has been reluctant to support -- and has indicated that it may even oppose -- the various initiatives which the United States proposes for consideration at the November GATT Ministerial.

However, there are several brighter aspects of our trade relationship which may to some degree counterbalance these negative points. India in recent years has taken steps to liberalize and streamline its overall import regime, a trend which the United States strongly supports. India also has aided U.S. objectives in North/South discussions on trade in UNCTAD and in the GATT by taking positions considerably less strident than many of its G-77 cohorts.

The tenor of U.S.-India trade relations will be affected in considerable measure by India's ultimate policy stance with respect to the U.S. initiatives for the GATT Ministerial. The United States has taken, and continues to take, gradual steps to improve our trade relationship with India, particularly in view of India's import liberalization moves. However, even our limited steps in this direction are made more difficult by India's own policy positions and by the Congressional and domestic criticism they generate. For example, in the subsidy case on industrial fasteners, India refused to provide information which would have enabled Commerce to set the countervailing duty rate at the real level, presumed to be quite small, rather than at the imputed rate of 17.5 percent. India's unwillingness to submit such information placed USTR in a very difficult position when the domestic industry pressed for expedited removal of the products from GSP following Commerce's announcement of its intention to revoke the countervailing duty order on the duty-free fastener items. Ambassador Brock ultimately decided in India's favor by refusing to expedite the GSP review, but his decision would have been considerably easier had the countervailing duty originally been set at the actual rate rather than the inflated rate of 17.5 percent.

Given this general context, it would be extremely difficult domestically for the Administration to propose that the United States institute special trade measures for India's benefit.

Recommendation

That no major package of trade concessions for India be contemplated, although the USG would continue to make individual trade decisions which are beneficial to India, provided that they

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support U.S. positions in the GATT Ministerial and continue to make progress in liberalizing their import regime, especially in cases where U.S. export interests are affected.

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